Federal Accounting Standards Advisory Board

April 5, 2018

Memorandum

MEMBER ACTIONS REQUESTED:
• Please provide responses to the question on page 4 before April 16

To: Members of the Board

From: Grace Wu, Assistant Director

Wendy M. Payne /s/

Through: Wendy M. Payne, Executive Director

Subject: Updated New Materiality Section – Tab B[1]

MEMO OBJECTIVE

The objective of this memorandum is to seek the Board's input and approval on the updated materiality section.

BRIEFING MATERIAL

This memorandum includes the updates on the new materiality section.

BACKGROUND

During the February Board meeting, a proposed new materiality section was discussed. The proposed materiality discussion has no substantive changes from the original materiality discussion. Instead, the current FASAB materiality guidance was updated and centralized for a clearer definition. In addition, a thorough discussion of related federal environment considerations was added to address the federal government's unique financial reporting requirements. The Board's feedback on the new materiality section was positive, with only minor edits. The Board also suggested adding qualitative and disclosure adequacy discussions to have full coverage of different topics related to materiality. Below is an updated materiality section based on the last meeting's inputs.

[1] The Staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Updated Materiality Section

The updated proposed section and discussion immediately follow this text. Text that has been bolded indicates new language, and text that has been crossed out indicates deletions from February's proposed language. The italicized text labeled "discussion" is staff's explanation of the new wording or other changes:

Materiality (proposed section)

191a. **Reporting entities consider materiality in the application of specific requirements to information in their general purpose financial reports. The Board intends that financial information presented in accordance with generally accepted accounting principles will not contain misstatements, including omissions of information that is material. Such omissions include information necessary for intended users to understand the effect of material transactions and events on the information conveyed in the financial statements. This section provides principles relating to the application of materiality to financial information.**

- *Discussion:*
    1. *Introductory section was added based on request from last meeting.*
    2. *The third sentence was added to bring the concept of disclosure completeness.*

191b. The omission or misstatement of information is material if, in the light of surrounding **facts and** circumstances, there is substantial likelihood that the judgment of a reasonable financial report user relying on the information would change or be influenced by the inclusion or correction of the information.

191c. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires the appropriate and reasonable application of judgment considering the specific facts and circumstances, and the size and nature of the misstatement or omission.

- *Discussion:*
    1. *Moved from old 191f to here to consider connection of the discussion among the paragraphs.*

191d. Materiality should be considered individually and in the aggregate and include both qualitative and quantitative considerations. Information that is not considered material from a quantitative standpoint may be considered qualitatively material if it would influence or change the judgment of the financial report user.

191e. **Materiality judgments involve both quantitative and qualitative considerations. Qualitative considerations include the public accountability of the entity under audit, various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions as well as a variety of other factors**

that may affect user's judgements about the information. Consequently, the Board cannot specify a uniform quantitative threshold for materiality. Further, the Board **cannot** predetermine what could be qualitatively or quantitatively material in a particular situation.

- *Discussion:*
    1. *Qualitative discussion was added per last Board meeting discussion.*
    2. *There were discussion about whether "does not" would be more appropriate in the last sentence. Staff believes "cannot" is appropriate because it is not feasible to make such determinations in advance of a particular situation especially from qualitative point of view. Does the Board prefer "cannot" or "does not"?*

191f. Financial reporting should provide information that is useful to citizens, Congress, federal executives, and federal program managers in understanding or making rational decisions about the allocation and use of resources in the federal government. The information should be comprehensible to those who have a reasonable knowledge of the entity's or the federal government's activities and are willing to study the information with reasonable diligence.

191g. In applying the concept of materiality, the needs of the users of the annual financial report should also be considered. In the federal government environment, such needs generally differ from those of users of commercial entity financial statements. For example, federal government financial statement user needs extend to having the ability to assess the efficiency and the effectiveness of the entity's programs. Further, compliance with budget and other finance-related laws, rules, and regulations is also a significant consideration of such users. ~~Consequently, the Board cannot specify a uniform quantitative threshold for materiality. Further, the Board does not predetermine what could be qualitatively or quantitatively material in a particular situation.~~

- *Discussion:*
    1. *Since qualitative discussion was added in 191e, the wording after "consequently" would fit better to that section. As such, it was moved.*

191h. Materiality applies to all required information included in the financial report and, therefore, is not limited to the financial statements and related notes.

- *Discussion:*
    1. *" required" was added to define the scope of the information as discussed in last Board meeting.*

191I. In order to emphasize that materiality should be considered in applying all accounting standards, the Board has decided to place a notice at the end of each Statement. The notice will read as follows:

The provisions of this Statement need not be applied to information if the effect of applying a provision(s) is immaterial.[2]

- *Discussion:*
    1. *The footnote (see below) will be added in the standards to remind user reviewing this section when they apply the materiality definition.*

Question for the Board:

Question 1: Does the Board agree on the updated changes? If not, do you have any suggested improvements?

[2] **Refer to SFFAC 1 *Objectives of Federal Financial Reporting* seventh chapter titled *How Accounting Supports Federal Financial Reporting* for detail discussion of the materiality definition.**